

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF RHODE ISLAND

BACOU-DALLOZ USA, INC.;
BACOU-DALLOZ USA SAFETY, INC.

v.

CA No. 00-404-T

CONTINENTAL POLYMERS, INC., f/k/a
1. HOWARD LEIGHT ENTERPRISES, INC.

MEMORANDUM AND ORDER

ERNEST C. TORRES, Chief Judge.

Bacou-Dalloz USA, Inc., (Bacou) and its subsidiary, Bacou-Dalloz USA Safety, Inc., (Bacou Safety) brought this declaratory judgment action seeking a declaration that they have no further obligation under a letter of intent signed by Bacou and Howard S. Leight & Associates, Inc., d/b/a Howard Leight Enterprises, Inc. (HLI), now known as Continental Polymers, Inc. (Continental), on January 12, 1998. Continental has counterclaimed, alleging breach of contract, breach of the implied covenant of good faith, and misrepresentation.

After hearing the evidence presented during the second of two bench trials, this Court finds that judgment should be entered for Bacou on both its declaratory judgment claim and Continental's counterclaims.

Facts

Background

HLI was a manufacturer of hearing protection products. Its products included disposable earplugs made of polyurethane foam that was produced by combining latex and a prepolymer material.

Howard Leight was the principal shareholder in HLI and John Dean was its CEO. Leight and Dean planned to expand their business by producing bandages and other foam products that they felt could be manufactured from the same prepolymer material used in making disposable earplugs.

Bacou Safety manufactured a variety of workplace safety products and, in an effort to expand its product line, began negotiating to acquire HLI. In early November 1997, negotiations broke down because the parties could not agree on a purchase price.

The Manufacturing Process

In order to explain the subsequent dealings between the parties that gave rise to this litigation, it is necessary to describe the method for making foam earplugs.

The quality of the foam is affected by a number of factors including the composition of the prepolymer material from which the foam is made and the processes utilized by the manufacturer. Since manufacturing processes and plant conditions may vary from manufacturer to manufacturer, it is important for the prepolymer

supplier to be familiar with a manufacturer's processes and to work with the manufacturer in developing a prepolymer that is suitable for that manufacturer. Accordingly, there are a variety of prepolymers on the market and manufacturers customarily test a prepolymer under actual manufacturing conditions in order to determine whether it is suitable.

Because the quality of foam earplugs is determined, primarily, by the prepolymer from which they are made and the techniques used in processing it, the type of prepolymer purchased by a manufacturer and the processes used by the manufacturer are considered proprietary information. Therefore, earplug manufacturers often require their prepolymer suppliers and other vendors to sign confidentiality agreements. HLI, itself, obtained confidentiality agreements from vendors, consultants and customers, including its main supplier of prepolymer, Hampshire Chemical Corporation.

The January 12 Letter

In December of 1997, shortly after negotiations between Bacou Safety and HLI broke down, Walter Stepan, Bacou Safety's CEO, and Philip Barr, Bacou Safety's Executive V.P., CFO, and general counsel, informed Leight and Dean that Philip Bacou, Bacou's CEO was coming to Rhode Island and they invited Leight and Dean to meet with Philip and explain why they had decided not to sell HLI to Bacou Safety.

On Saturday, January 10, 1998, Bacou, Stepan, Barr, Leight and Dean met for dinner at the Westin Hotel in Providence. Leight explained that the price of \$120 million offered by Bacou Safety was \$10 million less than what he was willing to accept. Leight also stated that he was concerned about the future employment of his management team and that he desired to remain active in the field. Stepan suggested ways in which those concerns might be addressed and the parties agreed to meet again the next day at Stepan's home.

During the meeting at Stepan's home, Stepan offered to make Leight a director of Bacou Safety's parent company, give him stock options and hire him as a consultant. While Leight felt that this proposal narrowed the gap between the parties, he continued to press for a purchase price that was \$5 million higher than Bacou Safety's offer arguing that HLI was worth more because it planned to begin making its own prepolymer. Stepan responded that Bacou Safety was not interested in getting into the business of producing prepolymer.

At that point, Leight and Dean went for a walk so that they could confer privately. When they returned, they proposed establishing a separate company to produce prepolymer and selling HLI to Bacou Safety if Bacou Safety would agree to purchase its prepolymer from their company for at least five years and operate HLI as a division of Bacou Safety with Dean as COO. Leight and

Dean based their proposal on the knowledge that HLI was buying between four and five hundred thousand pounds of prepolymer annually from Hampshire Chemical at approximately \$2.00 per pound which, over five years, would translate into sales of about \$5 million. Stepan agreed to those terms and, that evening, Barr and Bacou Safety's outside counsel modified drafts of the acquisition documents that had been prepared during the previously failed negotiations. In addition, they drafted a letter formalizing the parties' agreement that Leight would become a Bacou director; that Bacou would retain Leight as a consultant; that Leight would be awarded options to purchase Bacou stock and that for a five-year period, Bacou Safety would purchase its prepolymer from Howard Leight Enterprises (HLE), the new company being formed by Leight and Dean. The portion of the letter relating to the purchase of prepolymer stated:

This will confirm that Bacou USA Safety, Inc., will enter into a supply agreement with HLI pursuant to which Bacou USA Safety, Inc., agrees to purchase its requirements for polyurethane-prepolymer from HLE for a period of five years provided that the quality and price of such raw material are equivalent to that which is then used by HLI and available from third party suppliers.

Copies of the draft letter and the documents related to Bacou Safety's acquisition of HLI, immediately, were faxed to HLI's counsel in California for review.

The following day, Monday, January 12, the parties met at the

Providence office of Bacou Safety's counsel. After numerous telephone conversations and faxes between counsel for Bacou Safety and HLI, the letter (the "January 12 Letter") was signed by Stepan, Barr and Leight.

The closing on the purchase of HLI's assets occurred on February 27, 1998. At the closing, HLI's counsel suggested drafting the prepolymer supply agreement contemplated by the January 12 Letter, but Bacou Safety took the position that it was premature to do so because, among other things, HLE had not yet constructed a plant to manufacture prepolymer.

As provided in the January 12 Letter, Leight was elected to Bacou's Board; he was awarded stock options, and he was hired as a consultant to Bacou Safety. In addition, Dean was made president of the HLI division of Bacou Safety, and three other HLI executives, Bob Hanover, Ken Meyers, and Thomas Wagner, were given employment contracts by Bacou Safety.

The Negotiations with Hampshire/Dow

Soon after the closing, problems began to develop as a result of the inherent conflict of interest that Dean faced as both president of Bacou Safety/HLI and a shareholder in HLE, Bacou Safety's prospective supplier of prepolymer. Because of that conflict, Barr assumed responsibility for negotiating with Hampshire Chemical, the company that had been supplying prepolymer to HLI.

In April 1998, Hampshire Chemical learned of the agreement between Bacou Safety/HLI and HLE and expressed a strong interest in keeping HLI's business. Hampshire also expressed concern that confidential information about HYPOL, its prepolymer, could be obtained by Leight and Dean and used by HLE in competing with Hampshire. A short time later, Dean resigned his position at Bacou/HLI and Hampshire Chemical was acquired by Dow Chemical.

In June 1998, Thomas Klein succeeded Dean as president of Bacou/HLI and he directed Mak Hussain, Bacou Safety's purchasing agent, to seek price concessions from all of the company's vendors. Klein also discussed with Thomas Wagner, Bacou Safety/HLI's V.P. of Manufacturing and Distribution, the need for Bacou Safety/HLI to develop alternate suppliers for all of its materials, including the prepolymer being purchased from Hampshire/Dow. When Stepan, later, informed Klein of Bacou Safety/HLI's plan to purchase its prepolymer from HLE, Klein expressed surprise because HLE had never before made prepolymer and its plant had not yet been constructed.

In September 1998, Klein notified Wagner, Meyers, Hanover, Stepan and Barr that Bacou Safety/HLI intended to meet with Andy Sanford, a sales representative for Dow which, by then, had acquired Hampshire Chemical. The meeting was to take place at a trade show in Los Angeles on October 27 and Klein's purpose was to seek lower prices for HYPOL, the prepolymer that Bacou Safety/HLI had been purchasing. Around the same time, as a result of

conversations with Stepan and Barr, Klein told Meyers, Hanover and Wagner that, while HLE was to be Bacou Safety/HLI's preferred supplier of prepolymer as long as its product satisfied Bacou Safety/HLI's requirements, he, also, wanted to maintain a relationship with Dow in order to ensure a continued source of supply in the event that HLE's prepolymer proved unsatisfactory.

At the October 27 meeting with Dow, Klein reiterated Bacou Safety's desire for a substantial reduction in the price that it was paying for HYPOL. At that time, Bacou Safety/HLI was paying \$2.09 per pound and the price was lowered to \$1.89 per pound after a specified quantity had been purchased. Dow offered to reduce its price in exchange for a long-term commitment by Bacou Safety but Klein rejected that overture, stating that Bacou Safety intended to significantly expand its earplug business and wanted lower prices without any strings attached based on the increase of volume of prepolymer that it expected to buy. During the meeting, Klein fended off inquiries about the agreement between Bacou Safety/HLI and HLE by saying that it was Bacou's policy not to discuss its dealings with its vendors. The meeting ended without any agreement.

Klein continued to have concerns about when HLE's plant would be completed and whether HLE would be able to supply Bacou Safety/HLI's need for prepolymer. A tour of the plant, conducted in the fall of 1998, did little to allay those concerns. At that

time, the plant, which was located in Mexico, was still under construction but nearing completion. Stepan and Wagner accompanied Klein on the tour but they were unable to see much of the plant because Dean expressed concern about revealing proprietary information.

Around the same time, Dow's patent for HYPOL had expired and several competitors began offering similar prepolymers at reduced prices. Sanford received reports that Mace, one of Dow's competitors, was selling its prepolymer for \$1.50 per pound and that other competitors were quoting prices as low as \$1.35 per pound.

Dow responded to the competitive pressure in two ways. First, it began developing and promoting a new product called Vorastar that Dow claimed was superior to HYPOL and other prepolymers because it addressed environmental concerns being raised about such products. Second, in the meantime, Dow indicated a willingness to reduce its prices for HYPOL in order to hold onto its customers.

Dow's willingness to reduce its prices was evidenced by a series of price-reduction proposals that it made to Bacou Safety/HLI after the October 27 meeting in Los Angeles. Until late December of 1998, the lowest price that Dow proposed was \$1.63 per pound and all of the proposals had been rejected. Sanford, then, pressed Hussain to find out what price would be acceptable and was told that Bacou Safety/HLI was expecting a price of \$1.50 per

pound. Ex. 21. When Sanford relayed that to his superiors, he was told to "sit on it" for awhile.

On January 31, 1999, Dean wrote to Phil Barr, informing him that HLE had completed construction of its plant in Mexico and was ready to begin manufacturing a prepolymer that was equivalent to HYPOL. Three days later Sanford wrote to Hussain stating that Dow would sell HYPOL to Bacou Safety/HLI for \$1.56 per pound and that in order to make up for the reduction of its profit margin, it would be moving quickly to introduce Vorastar into the market. Ex. 27. Although Sanford could not recall how much profit Dow would have made at \$1.56 per pound, he was sure that Dow would not have sold HYPOL at a loss.

The Discussions Regarding a Supply Agreement

In February 1999, relations between Bacou Safety and Continental began to get testy. HLE requested a sample of the latex used by Bacou Safety/HLI in order to mix the latex with its prepolymer and test the foam that was produced. Bacou Safety/HLI refused because it had worked with its supplier, Union Carbide, to develop the latex and considered the composition of the latex to be proprietary information. HLE, then, acquired a sample directly from Union Carbide. Later, Barr discovered that HLE had tested the latex and its prepolymer by making earplugs with molds that it still had. Accordingly, Bacou Safety/HLI became concerned that HLE might become a competitor in the earplug manufacturing business.

On February 4, 1999, Klein, Wagner and Ed Woo, Bacou Safety/HLI's vice president of research and development, met with Dean, Meyers and Hanover for the purpose of preparing a formal supply agreement between Bacou Safety/HLI and HLE which had changed its name to Continental.¹ At that meeting, it became clear that the parties had radically different views regarding the terms of the agreement. Bacou Safety/HLI's position was that the January 12 Letter simply outlined what the general terms of the Supply Agreement were to be and that the details would be negotiated by the parties. Dean's position was that the January 12 Letter, in effect, was the Supply Agreement and that there could be no modifications or additional terms unless Bacou was willing to make concessions in exchange.

The disagreements with respect to the terms of the proposed Supply Agreement are set forth in Klein's February 4, 1999, memorandum to Stepan and Barr. Ex. 27. The four areas of dispute were inter alia: (1) how much of Bacou/HLI's requirements for prepolymer had to be purchased from Continental; (2) how the quality was to be determined; (3) the price to be charged for the prepolymer; and (4) whether Continental was required to sign a confidentiality agreement.

Bacou Safety/HLI continued to be concerned about Continental's

¹By then, Meyers and Hanover had left Bacou Safety/HLI and were working for Continental.

reliability as a supplier of prepolymer because Continental had no track record for producing prepolymer and its ability to ship prepolymer depended, in part, on obtaining export licenses from the Mexican government. Accordingly, Bacou Safety pressed for the right to buy a small percentage of its requirements from a different supplier in order to maintain a backup source of supply. However, Continental insisted that, unless Bacou Safety agreed to a higher price, it must purchase 100% of its requirements from Continental.

Since Continental never before had produced prepolymer, Bacou Safety/HLI wanted to be certain that the prepolymer was satisfactory for its purposes. Accordingly, Bacou Safety proposed that Continental's prepolymer be subject to testing before Bacou Safety was obliged to accept it. Continental would not agree to any testing requirements. Continental also rejected a proposal that the prepolymer be made according to specifications established by Bacou Safety/HLI. Continental's position, as expressed by Dean, was that its prepolymer would be equivalent to Dow's HYPOL and that Bacou Safety/HLI would be required to accept it and to make it work by adjusting Bacou Safety HLI's manufacturing process, if necessary.

With respect to price, Bacou Safety/HLI proposed a price of \$1.56 per pound which it maintained was the price for which it could purchase HYPOL from Dow. Continental viewed that as a

"manufactured" price at which it would be impossible for Continental to make a profit. Accordingly, Continental insisted on a price of \$2.00 per pound which it maintained was the prevailing market price both then and when the January 12 Letter was signed.

Finally, Bacou Safety/HLI wanted Continental to execute a confidentiality agreement covering information about the materials and methods used in its manufacturing process. Continental rejected that proposal, as well. The reason given by Dean was that all of Continental's principals, individually, had signed confidentiality agreements in connection with their employment or consulting contracts with Bacou Safety.

During the next few months, the parties had numerous conversations in an effort to resolve their differences. At one point, Bacou Safety/HLI issued a purchase order for 10,000 pounds of prepolymer at \$2.00 per pound, specifying that 3,000 pounds would be shipped immediately and tested; and, if it was found satisfactory, the remaining 7,000 would be shipped. Dean refused to fill that order on the grounds that the order described the prepolymer as HYPOL which was Dow's trade name and the quantity was so small that there might be variations in the quality that would make it unsuitable for testing.

About a month later, Barr and Dean began a series of meetings, pursuant to which Barr prepared six different drafts of a proposed supply agreement in which Bacou Safety/HLI made a variety of

concessions with respect to the proposals it advanced at the February 4 meeting. Each draft was prepared after conversations between Barr and Dean that Barr understood to have resulted in agreement on the points that separated the parties. Those drafts included a provision that, for a period of time, Bacou Safety/HLI would pay the \$2.00 per pound demanded by Continental in exchange for which Bacou Safety/HLI would be allowed to purchase some of its prepolymer from a backup supplier. Another provision was that, if Continental's prepolymer did not produce satisfactory results, Bacou Safety/HLI would try to adjust its manufacturing process and, if satisfactory results still were not achieved, Bacou Safety/HLI would work with Continental in an effort to revise the formula. In addition, Bacou Safety proposed to eliminate the need for a confidentiality agreement by maintaining only a buy-sell relationship with Continental.

Dean rejected all of the drafts and, in another effort to break the stalemate, Bacou Safety/HLI issued another purchase order. The second purchase order also was for 10,000 pounds of prepolymer at \$2.00 per pound but it called for delivery of the entire 10,000 bounds which Bacou Safety/HLI planned to use for testing. Continental refused to fill that order, too, but offered no explanation.

Barr made one final effort to break the impasse by proposing to eliminate any requirement of a confidentiality agreement by

maintaining only a buy-sell relationship between the parties but that proposal, too, was rejected by Dean. Consequently, by August of 1999, it was clear that the relationship between the parties had soured and that they were hopelessly deadlocked.

Travel of the Case

About 11 months later, Bacou and Bacou Safety brought this action seeking a declaration that it had no further obligations under the January 12 Letter. Continental responded with a counterclaim alleging "breach of the letter agreement dated January 12, 1998"; breach of Bacou Safety's "covenant of good faith and fair dealing which was inherent in the January 12, 1998, letter agreement" and "misrepresentations" which led Continental to incur the expense of constructing and equipping the plant in Mexico.

This Court granted Bacou's motion for summary judgement on the counterclaims for breach of contract and breach of the covenant of good faith and fair dealing on the grounds that the January 12 Letter was merely an agreement to agree that lacked sufficient terms to amount to a contract and that, in the absence of a contract, there could be no contractually implied covenant of good faith and fair dealing. Memorandum and Order, C.A. No. 00-404T (D.R.I. July 10, 2002).

The case, later, was transferred to Judge Lisi who conducted a bench trial with respect to the declaratory judgment claim and the counterclaim for fraudulent misrepresentation. Judge Lisi

entered judgment for Bacou on both claims. Bacou Dalloz USA, Inc. v. Continental Polymers, 344 F.3d 22, 26 (1st Cir. 2003).

Continental appealed and the Court of Appeals held that the January 12 Letter contained sufficient promises to establish mutuality of obligation and that Judge Lisi erred by excluding the testimony of Rex Lowry, one of Continental's witnesses, on hearsay grounds. Bacou Dalloz USA, Inc., 344 F.3d at 29-31. Accordingly, it reversed and remanded the case for a new trial on all claims. Id.

Analysis

I. The Contract Claims

The Court of Appeals held that, under Rhode Island law, not all "agreements to agree" are unenforceable and held that the January 12 Letter was an enforceable contract because it "does not condition the parties' obligations" on any "illusory promises resulting in a lack of mutuality of obligation." Id. at 27. More specifically, the Court of Appeals held that:

. . . The fact that the parties were to negotiate [the] details at a future date does not render illusory the obligation incurred under the January 12 letter. The parties clearly agreed to enter into a supply agreement consistent with the terms outlined in the January 12 letter.

Id.

The Court of Appeals expressly refrained from holding that the January 12 Letter, itself, was a supply agreement. Id. n. 2. ("We do not hold that the January 12 letter was itself the Supply

Agreement."). Indeed, it is clear that, while the January 12 Letter may have been an enforceable agreement to agree that required the parties to make a good faith effort to negotiate a supply agreement consistent with the terms outlined in the letter, the letter, itself, was not a supply agreement.

For one thing, the January 12 Letter states that Bacou "will enter into a supply agreement with HLE" [emphasis added], thereby plainly indicating that the parties contemplated that an agreement separate and distinct from the letter would be entered into at some time in the future. If the parties had intended the January 12 Letter to be the Supply Agreement, there would have been no need for them to enter into a supply agreement in the future.

The fact that Leight and Dean, themselves, did not view the January 12 Letter as the supply agreement is underscored by the fact that, at the closing, their counsel suggested that a supply agreement be drafted at that time.

In addition, Leight acknowledged, at trial, that he did not understand or intend that the January 12 Letter would require his company to supply prepolymer if the market price declined to a level at which it could not make a profit. Thus, even in Leight's eyes, the January 12 Letter lacked the mutuality of obligation that would be required to deem it a supply contract.

Here, it is clear that Bacou Safety fulfilled its obligations under the January 12 Letter by making a good-faith effort to

negotiate a supply agreement consistent with the terms outlined in the Letter. It is equally clear that Dean frustrated those efforts by taking an unreasonably intransigent position based on his erroneous view that the January 12 Letter, in effect, was the Supply Agreement and left no room for negotiation.

A. Price

The January 12 Letter provided that the price to be paid by Bacou Safety would be the price "available [to it] from third party suppliers." When the discussions between the parties took place, that price was \$1.56 per pound, the price at which Dow had agreed to sell HYPOL to Bacou. The protracted negotiations that preceded Dow's agreement to reduce its price and the circumstances under which that agreement was reached indicate that Dow's price was not "artificially manufactured" as Continental asserts. Dow made several proposals that were rejected by Bacou Safety and it took three months for Dow to arrive at a price acceptable to Bacou Safety. Moreover, Dow had several incentives to reduce its price. Its patent on HYPOL had expired and it faced increased competition from companies that were undercutting Dow's price. In addition, Bacou Safety/HLI was Dow's largest prepolymer customer and Dow could ill afford to lose that customer.

Continental has failed to present any evidence supporting its assertion that Dow's price was "artificially manufactured." Dow's price was consistent with the prices apparently being quoted by

some of its competitors. There is no indication that Bacou Safety/HLI was the only customer to which Dow offered a price reduction. On the contrary, Sanford, Dow's sales representative, stated that Dow, also, had made reductions in the prices charged to other large volume customers. Nor is there any evidence that Dow raised its price above \$1.56 after Bacou and Continental parted ways. Finally, it appears from Sanford's testimony that Dow still was able to make a profit at that price.

Consequently, Bacou Safety acted reasonably and in good faith in proposing a price of \$1.56 per pound and in agreeing to pay a higher price in exchange for being allowed to maintain an alternate source of supply. By contrast, Continental acted unreasonably in insisting on a price of \$2.00 per pound and rejecting Bacou Safety's proposed compromise.

B. Quality

The January 12 letter provided that the quality of prepolymer was to be "equivalent to that . . . then used by [Bacou Safety/HLI] and available from third-party suppliers." As previously stated, the parties disagreed with respect to both the standard for measuring quality and the method for determining it. Bacou Safety/HLI maintained that it had to be able to use the prepolymer in its manufacturing processes. Therefore, Bacou Safety/HLI took the position that either the prepolymer should be manufactured according to Bacou Safety/HLI's specifications or Bacou

Safety/HLI's obligation to accept it should be contingent upon satisfactory test results. Dean, on the other hand, insisted that Continental's prepolymer was "equivalent" to the HYPOL previously used by HLI and that Bacou Safety/HLI was obliged to accept it unconditionally. Dean took the position that any problems experienced by Bacou Safety/HLI in using the prepolymer should be resolved by Bacou Safety/HLI either adjusting its manufacturing processes or working with Continental to revise the formula for producing the prepolymer.

Bacou Safety's position was perfectly reasonable and consistent with the terms outlined in the January 12 Letter. "Equivalent quality" is a relative term that lacks any precise definition. In this case its vagueness is underscored by the fact that there were a number of different prepolymers on the market, and a prepolymer that might produce a satisfactory result for one manufacturer might not produce a satisfactory result for a manufacturer using different processes or materials.

For that reason, there was no uniform standard of "quality" and it was common practice for manufacturers to require satisfactory testing of a prepolymer as a condition of acceptance.

Accordingly, it was Continental that acted unreasonably in refusing to allow testing and in rejecting Bacou Safety's proffered compromise of working together to revise the formulation of Continental's prepolymer if it did not produce satisfactory

results.

C. Confidentiality

The fact that the January 12 letter makes no express mention of confidentiality does not mean that Bacou Safety's request that Continental sign a confidentiality agreement was unreasonable or indicates bad faith. As already noted, prepolymer suppliers are privy to information regarding the processes and materials used by their manufacturer customers and they, obviously, know the precise nature of the prepolymer that they sell to the manufacturer. Because manufacturers consider such information to be proprietary, it is common practice for manufacturers to request or require suppliers to execute confidentiality agreements promising not to disclose that information. Indeed, before it was acquired, HLI, itself, had obtained confidentiality agreements from a number of its suppliers, including Hampshire Chemical and LMI, its prepolymer suppliers.

In this case, Bacou Safety had an additional reason for requesting a confidentiality agreement, namely, the fact that Continental still had the molds necessary for manufacturing earplugs which gave rise to a concern that Continental might become a competitor.

In short, it was perfectly reasonable and consistent with established practice in the industry for Bacou Safety to request that Continental execute a confidentiality agreement. What was

unreasonable was Dean's adamant refusal. The proffered explanation offered for that refusal was that employment and/or consulting agreements between Bacou Safety and Dean, Leight, Meyer, and Hanover, already contained confidentiality provisions. However, as Barr pointed out, those agreements afforded no protection against the possibility that Continental, itself, or other agents of Continental might disclose proprietary information.

D. Volume

The January 12 letter described a supply agreement under which Bacou Safety would purchase "its requirements" for prepolymer from Continental. While the parties did not specifically discuss how much of its prepolymer Bacou Safety/HLI had to purchase from Continental, "requirements" contracts commonly are understood to mean that a manufacturer will purchase all of the specified material that it uses from the vendor with which it contracts. Shader Contractors, Inc. v. United States, 276 F.2d 1, 5 (Ct. Cl. 1960); Brightwater Paper Co. v. Monadnock Paper Mills, 161 F.2d 869, 871 (1st Cir. 1947); see generally: 2 Corbin On Contracts, §6.5 (rev. ed. 1995); 3 Williston On Contracts, §7:12 (4th ed. 1992). Consequently, Bacou Safety's request that it be allowed to purchase some prepolymer from other sources was a departure from the terms outlined in the January 12 Letter.

However, the proposed modification was neither unreasonable nor indicative of bad faith. It was both prudent and customary for

manufacturers to maintain alternate sources of supply for critical materials in order to protect against the possibility that a principal supplier would be unable or unwilling to meet the manufacturer's needs. Indeed, prior to being purchased by Bacou Safety, it was HLI's policy to use more than one supplier for each material that it purchased.

Moreover, Bacou Safety/HLI had legitimate reasons for seeking to maintain an alternative source of supply. Continental never before had produced prepolymer. Furthermore, Continental's plant was located in Mexico and, in order to ship prepolymer to Bacou Safety, it was required to obtain export permits from the Mexican government. Therefore, it was reasonable for Bacou Safety/HLI to be concerned about Continental's ability to produce and deliver a reliable supply of prepolymer suitable for Bacou Safety/HLI's purposes.

Furthermore, the quantity of prepolymer that Bacou Safety/HLI sought to purchase from other sources was relatively modest and in exchange for that right, Bacou Safety/HLI offered to pay the \$2.00 per pound price demanded by Continental during the first 18 months of the supply agreement. Following this initial period, Bacou Safety proposed that it would continue to purchase more than 70% of its prepolymer from Continental.

In short, Bacou Safety fulfilled its obligation to negotiate in good faith in order to arrive at a supply agreement consistent

with the terms outlined in the January 12 Letter. Therefore, it is not liable for any breach of contract and it is entitled to be discharged from any further obligation or liability pursuant to that letter or pursuant to the implied obligation of good faith and fair dealing arising from that letter.

II. The Misrepresentation Claim

In order to prevail on its fraudulent misrepresentation claim, Continental must prove that: (1) Bacou Safety made a false representation of material fact; (2) Bacou Safety made the representation with the intent to deceive Continental; (3) Continental justifiably relied on the representation as true and (4) Continental was injured as a result. Banco Totta e Acores v. Fleet Nat'l Bank, 768 F.Supp. 943, 947 (D.R.I. 1991) (citing Cliftex Clothing Co., Inc. v. DiSanto, 148 A.2d 273 (R.I. 1959)).

Here, the alleged misrepresentation is that when Bacou Safety signed the January 12 Letter promising to enter into a supply agreement, it had no intention of doing so. See, Palmacci v. Umpierrez, 121 F.3d 781, 786-87 (1st Cir. 1997) (a promise may be a misrepresentation of fact if it is made without the intent to perform it). That allegation is based on the assertion that Bacou refused to agree to the terms outlined in the January 12 letter and on the "smoking gun" testimony of Rex Lowry.

The assertion that Bacou Safety refused to agree to the terms outlined in the January 12 Letter is at odds with the facts. As

previously stated, except for the request that it be allowed to maintain a backup source of supply in exchange for which it was willing to make concessions, Bacou Safety's negotiating position was perfectly consistent with the terms outlined in the January 12 Letter.

Furthermore, this Court gives no credence to Lowry's testimony. Lowry was hired by Dean as Security Supervisor and Safety Manager for HLI and, later, left to work for Bacou/HLI. He testified that sometime during September 1998, as he was walking by Klein's office, he noticed that Klein appeared to be very upset. Lowry said that, when he inquired, Klein stated that he had just spoken by telephone with Stepan and Stepan told him not to purchase prepolymer from HLE and, instead, to buy it elsewhere regardless of cost or quality.

There are a number of reasons why this Court does not find Lowry's testimony convincing. First, Stepan and Klein both unequivocally denied that any such statements ever were made and there is no plausible reason why Stepan would instruct Klein to purchase prepolymer elsewhere "regardless of cost or quality." Moreover, because Lowry was not involved in the dealings between Bacou Safety and Continental; and, because he did not have a close person relationship with Klein, it is difficult to believe that Klein would have confided in him about such a sensitive matter.

Lowry's testimony also is undermined by the fact that he is a

close friend of both Leight and Dean and he, apparently, left Bacou Safety/HLI under less than amicable circumstances. In addition, in its answers to interrogatories requesting the identity of relevant witnesses, Continental failed to list Lowry. Continental did not identify Lowry as a witness until the day that discovery closed and, thereafter, resisted Bacou Safety's efforts to take Lowry's deposition.

Finally, Lowry's testimony and the allegation that Bacou Safety/HLI never intended to honor the January 12 Letter are contradicted by Bacou Safety/HLI's conduct. Bacou Safety/HLI expended considerable time and effort in attempting to negotiate a supply agreement with Continental. Klein, Barr and others had numerous discussions with Dean over a period of three months; they made efforts to have Leight intervene in order to resolve disagreements; they presented six different drafts of a proposed supply agreement; and they issued two purchase orders in an attempt to obtain, at Bacou Safety's expense, a quantity of Continental's prepolymer for testing. In addition, many of Bacou's internal memoranda and meeting minutes indicate that it was genuinely attempting to reach an agreement with HLE. For example, in his September 17, 1998, e-mail to Meyers, Hanover and Wagner, Klein expressed his "preference to use the [HLE] material if at all possible." Exh. 16. Similarly, Klein's memorandum of the February 4, 1999 meeting with Dean stated that Bacou/HLI "sincerely want[ed]

to establish a positive relationship" with HLE, and minutes of Bacou USA's Board meeting on February 10, 1999 stated that "Mr. Stepan confirmed the Corporation's desire to proceed under the letter of January 12, 1998."

Bacou Safety/HLI also allowed its inventories to run down in anticipation of purchasing its prepolymer from Continental and it refused to make a long-term commitment to Dow in order to obtain price concessions. Such conduct is hardly one would expect from a party intent on subverting the January 12 agreement.

Conclusion

For all of the foregoing reasons, judgment may enter declaring that the plaintiffs have no further obligation or liability under the January 12, 1998, Letter Agreement. In addition, with respect to the defendants' counterclaims, judgment shall enter in favor of the plaintiffs.

IT IS SO ORDERED,

Ernest C. Torres
Chief Judge

Date: , 2005